SUMMARY OF THE STATEMENT OF THOMAS J. BLILEY, JR. ON BEHALF OF THE SOUND BANKING COALITION

APPLICATION FOR FEDERAL DEPOSIT INSURANCE FILED ON BEHALF OF PROPOSED WAL-MART BANK

April 10, 2006 Arlington, Virginia

The Sound Banking Coalition – which includes the Independent Community Bankers of America, the National Association of Convenience Stores, the National Grocers Association, and the United Food and Commercial Workers International Union – is opposed to Wal-Mart's application for a Utah industrial loan company (ILC) charter and opposed to the granting of Federal deposit insurance to a Wal-Mart Bank.

ILCs threaten the basic underpinnings of banking regulation in the United States due to the mixing of banking and commerce and the lack of consolidated supervision of the bank at the holding company level. These threats are particularly acute in this case given Wal-Mart's mammoth size and market reach, and its ability to quickly and easily expand into retail banking.

Wal-Mart has shown that it will not limit itself to the confines of its seemingly narrow ILC application. This is the company's fourth attempt to get into the banking business and it was not subtle about its intentions to use a bank to open branches in the past. In fact, when asked just after filing this application whether consumers would someday be shopping for their mortgages at Wal-Mart, the company's financial services director Tom McLean said, "We continue to look for what makes sense to the customer." Not only that, third parties will argue on Wal-Mart's behalf that a Wal-Mart Bank with branches and a full range of bank products would be a benefit and increase competition in the banking industry. These arguments – made by witnesses that Wal-Mart asked to testify – raise serious questions about the credibility of Wal-Mart's application and statements that it does not intend to open branches and operate as a retail bank.

Wal-Mart's application should be denied because the likelihood that the company will enter into retail banking poses an enormous, unjustifiable threat to taxpayers, consumers, small communities, small businesses, FDIC insurance, and the soundness of our banking system itself. As an ILC, Wal-Mart could establish banks in its retail stores, causing competitive problems for local bankers in much the same way that it has for local retailers. This would leave Wal-Mart as the only banking option in many small communities and force small businesses to hand their deposits over to, and apply for loans from, their biggest competitor.

Wal-Mart's application should be denied because Wal-Mart fails to meet the statutory criteria that the FDIC board is required to consider in reviewing insurance applications under Section 6 of the Federal Deposit Insurance Act. Wal-Mart fails to meet these criteria for the following reasons:

- Wal-Mart Bank would present a grave risk to FDIC insurance. The Federal Reserve has repeatedly warned of the dangers of ILCs, a threat that is magnified by the size and market power of Wal-Mart. History shows that Wal-Mart's size does not ensure it is safe. General Motors is proving that right now. Will GM's two ILCs safely weather the financial difficulties of their parent company? Unfortunately, we do not know the answer because there is no regulator empowered to examine the entire holding company for those risks.

- Wal-Mart Bank would have a destructive impact local communities. Wal-Mart has a pattern of entering local communities and running local competition out of business. Once local competition is destroyed, Wal-Mart is free to raise its prices, or even shut down its stores to open larger regional stores. Wal-Mart has repeated this pattern – aggressively harming local businesses and competition – many times. The states have been forced to step into the breach to protect their citizens in the absence of federal leadership. At least nine states are considering legislation that would block Wal-Mart from using an ILC charter to open bank branches within their borders.

- There are real threats to Wal-Mart's financial condition which must be considered. These include vulnerabilities to currency and oil price fluctuations as well as large potential liabilities for legal and regulatory violations.

- There are serious questions about Wal-Mart meeting FDIC standards for management character and fitness. The reports of violations of labor and environmental laws, alleged discrimination in employment and sales practices, and negative impacts on communities raise questions about the character of Wal-Mart's management. The picture these allegations paint is just what a group of Wal-Mart's shareholders found – that breaking laws and regulations is "far too commonplace" at Wal-Mart.

Under these circumstances, we do not believe that Wal-Mart's management should be extended the authority and responsibility that comes with an industrial bank charter and FDIC insurance, particularly in light of the fact that Wal-Mart will not be subject to consolidated supervision by the Federal Reserve.

Wal-Mart's application for an industrial bank charter does not meet the basic legal requirements upon which the FDIC judges such applications and it would open so broadly the ILC loophole in the BHCA that the long-time separation of banking and commerce would no longer be a recognizable principle, threatening FDIC insurance and the banking system as a whole. We urge you to reject Wal-Mart's application.

THE SOUND BANKING COALITION

STATEMENT OF THOMAS J. BLILEY, JR.

Before the

FEDERAL DEPOSIT INSURANCE CORPORATION

HEARING ON APPLICATION FOR FEDERAL DEPOSIT INSURANCE FILED ON BEHALF OF PROPOSED WAL-MART BANK

April 10, 2006

Arlington, Virginia

On behalf of the Sound Banking Coalition, I want to thank you for the opportunity to testify today regarding the application by Wal-Mart Stores, Inc. (Wal-Mart) for federal deposit insurance for the company's proposed industrial loan corporation. The members of the Coalition also want to commend you for holding these hearings. Wal-Mart is the largest commercial company in the United States – indeed the world. The issues raised by its application to acquire a bank charter are so numerous and complex – and raise such difficult policy issues – that this public discussion is essential.

The Sound Banking Coalition is a group of concerned organizations that have come together to try to close the industrial loan company (ILC) loophole to protect consumers and businesses against the competitive problems and the threat to FDIC insurance posed by ILCs. The members of the Sound Banking Coalition are the Independent Community Bankers of America, the National Association of Convenience Stores, the National Grocers Association, and the United Food and Commercial Workers International Union. For the reasons outlined in this testimony and in our letters to you dated August 10, 2005 and August 17, 2005, the Coalition is opposed to Wal-Mart's application for a Utah industrial bank charter and opposed to the granting of Federal deposit insurance to a Wal-Mart Bank.

Introduction

Wal-Mart's applications for an industrial bank charter and Federal deposit insurance raise serious policy and regulatory issues. The mixing of banking and commerce that would occur if Wal-Mart owned a bank, as well as the lack of consolidated supervision of the bank at the holding company level, threaten basic underpinnings of banking regulation in the United States. These threats are particularly acute in this case given Wal-Mart's size and market reach, and its ability to quickly and easily expand into retail banking.

The Federal Reserve on numerous occasions has opined on the threat posed by ILCs to the banking system and the insurance fund. In testimony before the House Financial Services Committee last month, newly-appointed Federal Reserve Board Chairman Ben Bernanke urged Congressional review and action with respect to the regulation of ILCs. More recently, on March 1, 2006, Federal Reserve Governor Donald L. Kohn testified to the Senate Committee on Banking, Housing and Urban Affairs that, "the Board continues to believe that Congress should *not* grant this new (de novo) branching authority to ILCs unless the corporate owners of these institutions are subject to the same type of consolidated supervision and activities restrictions as the corporate owners of other full-service insured banks."

The Board's current policy is clearly consistent with the views of former Board Chairman Alan Greenspan. In a letter to Representative James Leach (R-IA) on January 6, 2006, Chairman Greenspan described the current and growing threat to the nation's financial system posed by ILCs.

> When this exemption was adopted in 1987, ILCs were mostly small locally owned institutions that had only limited deposit-taking and lending powers. However, much has changed since 1987 and recent events and trends highlight the potential for this exemption to undermine important general policies established by

> Congress that govern the banking system and to create an unlevel competitive playing field among banking organizations. The total assets held by ILCs have grown by more than 3,500 percent between 1987 and 2004, and the aggregate amount of estimated insured deposits held by ILCs has increased by more than 500 percent since 1999.
>
> The character, powers and ownership of ILCs have changed materially since Congress first enacted the ILC exemption. These changes are undermining the prudential framework that Congress has carefully crafted and developed for the corporate owners of other full-service banks. Importantly, these changes also threaten to remove Congress' ability to determine the direction of our nation's financial system with regard to the mixing of banking and commerce and the appropriate framework of prudential supervision. These are crucial decisions that should not be made through the expansion and exploitation of a loophole that is available to only one type of institution chartered in a handful of states.

The depth and breadth of the concern about the ILC loophole generally, and Wal-Mart bank in particular, has radiated across the country. In the absence of federal leadership, states are taking matters into their own hands. At least nine states are considering legislation that would block Wal-Mart from using an ILC charter to open bank branches within their borders. Legislation in Iowa, Virginia and Maryland would ban ILC branches on the premises of a commercial affiliate. Bills in Illinois, Missouri, and Wisconsin would prohibit ILCs from doing any business in their states. Michigan and Pennsylvania would specifically bar branches of ILCs chartered in Utah. This state activity is indicative of nationwide concerns about this issue.

The state-by-state attention to the issue is not likely to abate, particularly in light of the newly-enacted law in Utah which validates contract language in which borrowers waive their rights to participate in class actions against lenders. This law may be used to cut-off consumer rights not only in Utah, but in other states in which Utah financial institutions do business. In addition, Utah is one of approximately 12 states that has removed the usury ceiling for consumer loans. If Wal-Mart secures an ILC charter, the lack of consumer protections may be problematic – especially given that Wal-Mart is currently the most frequently sued company in the nation.

The FDIC ought to recognize that the ILC loophole is a national problem that must be solved and that granting FDIC insurance to additional institutions, like Wal-Mart, will exacerbate the problem and create pressure for more dramatic approaches to limiting or closing the loophole.

Retail Banking – A Wal-Mart Bank in Every Store

As a general matter, the Coalition believes that Wal-Mart's application should be denied because the very possibility that the company will enter into retail banking poses an enormous, unjustifiable threat to taxpayers, consumers, small communities, small businesses, FDIC insurance, and the soundness of our banking system itself. As an industrial bank, Wal-Mart could establish banks in its retail stores, causing competitive problems for local bankers in much the same way that it has for local retailers. This would leave Wal-Mart as the only banking option in many small communities and force small businesses to hand their deposits over to, and apply for loans from, their biggest competitor.

Although Wal-Mart has narrowly drafted its application to make it appear that it would use an industrial bank charter primarily to process internal transactions, the company does not foreclose the possibility that it would eventually seek to branch and enter retail banking, an option that is permitted under Utah law. In fact, we believe that a careful examination of Wal-

Mart's application and the company's past efforts to obtain a bank reveal that this application is a first step toward an expansion into retail, branch banking.

This is Wal-Mart's fourth attempt to get into banking since 1999. That year, the company attempted to purchase a thrift in Oklahoma under another "loophole" in federal banking law, this one allowing "unitary thrifts" to be owned by non-financial institutions. The transaction failed when the Gramm-Leach-Bliley Act, which was enacted that year, closed the thrift loophole. Wal-Mart later attempted to partner with a Canadian bank and to purchase a California ILC. These attempts did not hide Wal-Mart's interest in getting into retail banking. And, perhaps as a result, these efforts failed due to regulatory and legislative disapproval.

Now, Wal-Mart insists that it is only interested in a charter for the purposes of internal transaction processing and that it will not get into retail, branch banking. Wal-Mart's past history and recent statements belie the limited nature of the application. Reporters from the Chicago Tribune asked Wal-Mart about its intentions following the filing of its application for FDIC insurance in July 2005. When pressed as to whether under its plans consumers would someday be shopping for their mortgages at Wal-Mart, the company's financial services director Tom McLean said, "We continue to look for what makes sense to the customer."[1] This statement makes Wal-Mart's narrowly drafted application and public denials about possible designs on branch banking appear to be disingenuous.

Some observers – including witnesses who will appear before you at these hearings – will tell you Wal-Mart's entry into retail banking will be a good thing. They claim that it will increase competition, force efficiencies on the marketplace and drive down costs. That can only be true if the limited scope of Wal-Mart's application is a sham. The very fact that these arguments are being made demonstrates Wal-Mart's interest in eventually using this charter to open branches in its stores. Although Wal-Mart has not made these arguments itself, the company has implicitly sanctioned the arguments by not correcting the record. In fact, it is our

---

[1] Becky Yerak and Josh Noel, *Wal-Mart plan has bankers on edge; Applications filed to run bank in Utah*, Chicago Tribune, July 20, 2005, at C1.

understanding that Wal-Mart has asked many of the witnesses speaking in favor of its application to testify. The fact that some may be making these arguments is disingenuous, at best. If it is true, as Wal-Mart claims, that the company intends to use its bank charter solely to process internal transactions, then all the arguments regarding increased competition and decreased prices must be ignored by the FDIC. They add nothing to this debate. If Wal-Mart and their defenders have another agenda, however, they have a duty to be forthright so that there can be an informed discussion of the issues.

Wal-Mart has pointed to the fact that it already has leases with independently owned banks to operate in about 1,000 of its approximately 3,200 U.S. stores. Wal-Mart have insisted this means that it does not want to open its own bank branches. This argument, however, misses some key facts. First, the term of the leases is not as long as Wal-Mart sometimes states. Many leases are for only five years with a right to renew for additional five year terms – but only if both parties agree to such a renewal. Second, it would not cost very much for Wal-Mart to simply break its leases with these bankers. Many of the leases include a liquidated damages clause that means Wal-Mart would only need to pay bankers the equivalent of one year's rent and then Wal-Mart could put its own bank branches into its stores. Third, the stores with banks in them are prime locations for Wal-Mart to place its own banks. The customer base and infrastructure is already there for a bank to be in the store. And fourth, of course, more than two-thirds of Wal-Mart stores do not have banks in them. This might allow Wal-Mart to become a 2,000 branch bank very quickly. By way of comparison, the U.S. bank that currently has the largest number of branches is Bank of America, with 5,800 branches nationwide.[2]

<u>Wal-Mart's Application Fails to Meet the FDIC Criteria for Approval</u>

Wal-Mart's application should be denied because Wal-Mart fails to meet the statutory criteria that the FDIC must consider in reviewing insurance applications under Section 6 of the

---

[2] Ted Griffith, *Bank of America to open first Delaware branches*, The News Journal, February 27, 2006, *available at* http://delawareonline.com/apps/pbcs.dll/article?AID=/20060227/NEWS/60227007/1006/NEWS.

Federal Deposit Insurance Act. Under that provision, the FDIC board is required to consider seven factors in any determination for deposit insurance. The factors are:

1. The financial history and condition of the depository institution;
2. The adequacy of the depository institution's capital structure;
3. The future earnings prospects of the depository institution;
4. The general character and fitness of the management of the depository institution;
5. The risk presented by such a depository institution to the Bank Insurance Fund or the Savings Association Insurance Fund;
6. The convenience and needs of the community to be served by such a depository institution; and
7. Whether the depository institution's corporate powers are consistent with the purposes of this Act.

It is important to note that these criteria are not narrow, rigid tests. They grant the FDIC the ability to assess the full range of impacts that an institution might have on the banking system and on local communities. Not only is there substantial room within these criteria for the FDIC to reject this application, a full evaluation of these factors inexorably leads to the conclusion that Wal-Mart's application cannot be approved. The FDIC simply cannot ignore the overwhelming evidence that Wal-Mart's application does not meet these criteria because, among other things:

- Wal-Mart Bank would present a grave risk to FDIC insurance;
- Wal-Mart's likely entry into retail banking would have a destructive impact on local communities;
- There are a number of threats to Wal-Mart's financial condition and future earnings; and
- There are serious questions about Wal-Mart meeting FDIC standards for management character and fitness;

I will address each of these points in turn.

1. Wal-Mart Bank Would Pose a Grave Threat to FDIC insurance and the Banking System Itself

Because of Wal-Mart's sheer size and volume of business, FDIC insurance would face significant exposure if the company is granted a bank charter. To the extent the bank or the parent company experienced financial problems, the losses to FDIC insurance could be very large. This is a principal reason the United States has historically kept banking and commerce separate. There are a number of ways an ILC can be negatively affected by a commercial parent company:

- Financial trouble at the commercial parent or a commercial affiliate can impair the ILCs ability to access necessary capital and credit sources in the financial sector;
- Inappropriate inter-company transactions such as excess dividends, manipulation of interest rates, and inappropriate loans, can drain the ILC's capital/profits;
- Reputational harm; and
- Operational risks from information sharing within the corporate family.

Commenting on the impact Wal-Mart's size and influence already has on dependent suppliers, Tom Rubel, CEO of consultant Retail Forward Inc. predicted that "if [Wal-Mart] ever stumbles, we've got a potential national security problem on our hands. They touch almost everything . . . if they ever really went into a tailspin, the dislocation would be significant and traumatic."[3] A company this large should not be permitted to place our banking system and the Bank Insurance Fund at a similar risk.

Wal-Mart faces particular risks that other banks, not to mention many other commercial enterprises, do not. Prominent examples of these risks include financial risks due to foreign currency fluctuations and fluctuations in oil prices. For example, Wal-Mart is exposed to

---

[3] Business Week, *Is Wal-Mart Too Powerful?,* Oct. 6. 2003, *available at* http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm

substantial risk when there are fluctuations in the yuan. More than seventy percent of goods sold by Wal-Mart are made in China.[4] Xu Jun, Wal-Mart China's director of external affairs, has pointed out that China is Wal-Mart's most important supplier in the world and noted, "If Wal-Mart were an individual economy, it would rank as China's eighth-biggest trading partner, ahead of Russia, Australia and Canada."[5] More than 5,000 Chinese enterprises have established steady supply alliances with Wal-Mart.[6] The company has recently made public plans to open 20 stores in China, increasing its total number of stores in China to 56. In addition, the company reportedly plans to hire up to 150,000 additional employees in the country over the next five years.

The commercial ties between Wal-Mart and China pose special risks because China is loosening its artificial control of the valuation of its currency. On July 21, 2005, the Chinese government dropped the yuan-dollar peg and lifted the value of the currency by more than two percent. The revaluation raised the price of Chinese goods, pressuring profit margins on an enormous proportion of the products sold in Wal-Mart. While this first step in floating the yuan resulted in a relatively modest increase of the currency, economists have estimated that China's currency policy has kept the yuan undervalued by as much as forty percent.[7] AG Edwards advised its clients regarding the float of the yuan: "We believe that China's decision. . .will have an immediate impact for U.S. retailers sourcing product out of China. U.S. retailers cost of goods sold will increase and, of course, their gross margins will decrease."[8] A sudden jump in the valuation of the yuan could have devastating consequences for Wal-Mart. If Wal-Mart becomes as dominant in the financial services sector as it has been in other segments of the economy, a decision made in Beijing regarding the valuation of its currency could put a Wal-Mart bank and, by extension, the Bank Insurance Fund at risk.

---

[4] Jiang Jingjing, *Wal-Mart's China inventory to hit US$18b this year,* China Business Daily, November 29, 2004, *available at* http://www2.chinadaily.com.cn/english/doc/2004-11/29/content_395728.htm.
[5] *Id.*
[6] *Id.*
[7] Dow Jones, *Retail Stocks Lower in 'minor' China Revaluation,* July 21, 2005.
[8] *Id.*

Wal-Mart also faces risks from rising energy prices. Wal-Mart's stock price fell last year in reaction to increased oil prices and CEO H. Lee Scott, Jr. admitted to worries "about the effect of higher oil prices" on the bottom line. Higher energy prices increase Wal-Mart's costs of importing and transporting the extraordinary volume of goods it sells, as well as the risk that as consumers spend additional funds on fuel they will have less to spend on goods at Wal-Mart. As Mr. Scott said, "Our customer continues to be impacted by higher gas prices, and it is difficult to improve our expense leverage in the current environment." These financial risks faced by Wal-Mart are not common among banks and create unique problems due to the size and scope of Wal-Mart's worldwide supply network and operation.

These risks are particularly significant because Wal-Mart, as an industrial bank, would not be subject to the same level of regulatory oversight as banks. The company would not face the same consolidated supervision at the holding company level, would not be subject to consolidated capital requirements, and would be subject to arguably weaker regulatory enforcement. This leaves insufficient safeguards to ensure that this massive company will not endanger the Bank Insurance Fund. We question the rationale for this differential treatment of ILCs. As the GAO recently reported to Congress, ILCs "pose similar risks to the bank insurance fund as other types of insured depository institutions." In fact, the same GAO report went further, stating that "from a regulatory standpoint, these ILCs may pose more risk of loss to the bank insurance fund than other insured depository institutions operating in a holding company."

- **Consolidated Holding Company Supervision:** Wal-Mart, as the parent company of Wal-Mart bank, would not be subject to consolidated holding company supervision. Although the bank would be subject to FDIC oversight, the FDIC has more limited regulatory powers with respect to holding companies and affiliates than does the Federal Reserve. The Bank Holding Company Act (BHCA) provides the Federal Reserve with the authority to examine the bank holding company itself and any of its non-bank subsidiaries at any time, while the FDIC has only limited examination authority, and is unable to examine affiliates of banks unless necessary to disclose the direct relationship between the bank and affiliate and the effect of the relationship on the bank.[9]

- **Consolidated Capital Requirements:** The Federal Reserve is also entitled to establish consolidated capital requirements to ensure that bank holding companies are a source of financial strength for the subsidiary bank. This source of strength doctrine has been codified in Regulation Y, which specifies that a bank holding company parent should be ready to provide capital to its bank subsidiary when needed. Failure to provide such assistance would enable the regulator to take enforcement action to protect the bank. In contrast, corporate parents of ILC's are not subject to these capital requirements.
- **Enforcement:** Finally, the Federal Reserve has broad enforcement authority under the BHCA and can issue cease and desist orders, impose civil penalties, and order a holding company to divest non-bank subsidiaries if it determines that ownership of the subsidiary presents a risk to the financial safety, soundness, or stability of an affiliated bank and is inconsistent with sound banking principles or the purposes of the BHCA.[10] The Federal Reserve is the only federal agency authorized to take such actions against bank holding companies.

The safeguards provided by Federal Reserve regulation are necessary to protect the Bank Insurance Fund against the potential risks presented by a Wal-Mart bank. Without these safeguards, it may be impossible for problems to be identified and managed in time to prevent deficiencies and damage to the federal safety net. A Wal-Mart bank is simply a risk that United States taxpayers should not be forced to take.

[9] Letter to Senator Tim Johnson from Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, June 25, 2003, at 4.
[10] *Id.* at 5.

2. A Wal-Mart Bank Would Have a Destructive Impact on Local Communities

Although Wal-Mart claims that it will simply use the industrial bank charter to process credit card, debit card, and electronic check transactions from its retail locations, Wal-Mart has not denied that it will pursue retail banking in the future. When asked whether shoppers could someday shop for mortgages at Wal-Mart, financial services director Tom McLean refused to say that Wal-Mart would not offer these types of retail banking services and instead replied, "We continue to look for what makes sense to the customer."[11] Certain statements in the filing also indicate that Wal-Mart's application is really an attempt to get its foot into the door of retail banking. For example, it states that it will offer short-term certificates of deposit to nonprofit and educational organizations, as well as "individual investors generated through deposit brokers." There is no detail as to who these investors will be, and no guarantee that the bank will not offer them additional banking services.

Further, the application is only the most recent in a series of unsuccessful attempts by Wal-Mart to enter the financial services industry. In 1999, Wal-Mart tried to purchase a small savings and loan company in Oklahoma, but was stopped by provisions of the Gramm-Leach-Bliley Act.[12] In 2001, it attempted to partner with the Canadian Toronto-Dominion Bank, but its application was rejected as deficient by the Office of Thrift Supervision.[13] The application with Toronto-Dominion was explicit in noting Wal-Mart's plan to offer retail banking services in its retail stores. In fact, one of the deficiencies in the application was that the plan contemplated having retail cashiers function as bank tellers.

Most recently, in 2002, Wal-Mart filed an application to acquire an industrial bank in California. The effort met with resistance from those concerned about the mixing of banking and

---

[11] Becky Yerak and Josh Noel, *Wal-Mart Plan Has Bankers on Edge,* Chicago Tribune, July 20, 2005, *available at* http://www.chicagotribune.com/business/chi-0507200160jul20,1,3606468.story?coll=business-utl

[12] Jenifer K. Nii, *Wal-Mart is Planning to Open a Bank in Utah,* Desertnews.com, July 19, 2005, *at* http://deseretnews.com/dn/view/0,1249,600149522,00.html

[13] Christopher Leonard, *Retailer Seeking Banking Inroads,* Arkansas Democrat Gazette, July 20, 2005.

commerce, and was ultimately blocked by the California legislature.[14] While right now Wal-Mart is publicly stating that it seeks only to save the costs of a third party processor for retail transactions, its current application is merely a continuation of its past efforts to enter into retail banking.

Granting Wal-Mart an industrial bank charter would allow it to immediately branch into more than 20 states under current law – and that number could easily grow. Wal-Mart's entrance into banking would have such a destructive impact on local communities and businesses throughout Utah and the United States that the mere possibility that it would use an industrial bank charter for retail purposes should be enough reason to deny the application. Wal-Mart has a pattern of entering local communities and using predatory pricing and other techniques to run all local competition out of business. Once local competition is destroyed, Wal-Mart is free to raise its prices, or even shut down its stores to open larger regional stores. There is no reason to believe that a Wal-Mart bank would not engage in the same practices and have the same effects on local banks.

A study conducted by Iowa State University revealed that, following Wal-Mart's expansion in the state, 555 grocery stores, 298 hardware stores, 293 building suppliers, 161 variety shops, 158 women's apparel stores, 293 building suppliers, and 116 pharmacies closed.[15] When Wal-Mart opened three Sam's Club stores in Oklahoma, local gas stations were initially pleased due to the business generated by traffic traveling to and from the stores. Wal-Mart quickly usurped the opportunity by providing gas below wholesale prices at its own stores, and caused local gas stations to lose a large volume of sales. A federal judge in the Western District of Oklahoma enjoined and restrained Sam's from selling motor fuel below cost as defined by the Oklahoma Unfair Sales Act, and the Tenth Circuit affirmed.[16] According to the Tenth Circuit, the evidence showed that "because of the volume of Sam's gasoline sales and its below-cost

---

[14] Mark Anderson, *Wal-Mart Will Look Elsewhere to Buy Bank,* Sacramento Business Journal, Oct. 2, 2002.
[15] Stone, *Competing with Discount Mass Merchandisers,* at http://www.econ.iastate.edu/faculty/stone/1995_IA_WM_study.pdf
[16] *See Star Fuel Marts, LLC, v. Sam's East, Inc.,* 362 F.3d 639, 643 (10th Cir. 2004).

pricing, competition was lessened in Oklahoma City [in much of the] area surrounding Sam's stores."[17]

Wal-Mart has repeated this pattern – aggressively harming local businesses and competition – many times. The grocery business is a prime example. Studies by Retail Forward, a market research firm, indicate that for every one Wal-Mart "Supercenter" opened, two local groceries will close.[18] The following is an explanation of the devastating effect that this can have on communities:

> As the number of supermarkets shrinks, more shoppers will have to travel farther from home and will find their buying increasingly restricted to merchandise that Wal-Mart chooses to sell -- a growing percentage of which may be the retailer's private-label goods. Meanwhile, the failure of hundreds of stores will cost their owners dearly and put thousands out of work, only some of whom will find jobs at Wal-Mart, most likely at lower pay.[19]

Indeed, some estimate that for every one job created by Wal-Mart, two are lost. Wal-Mart has also driven many American jobs overseas. Relentlessly seeking lower prices, the company has shifted much of its purchasing power overseas, where cheap labor and minimal government regulation result in cheaper goods. Gary Gereffi, a Duke University professor who studies global supply chains, has stated that Wal-Mart is one of the "key forces" propelling global outsourcing because it controls so much of the purchasing power of the U.S. economy.[20] As I stated above, Wal-Mart is a huge – and growing – trade partner with China. In 2004, Wal-Mart reportedly purchased $9 billion-worth of goods directly and another $9 billion indirectly

---

[17] *Id.* at 649.
[18] Business Week, *Is Wal-Mart Too Powerful?,* Oct. 6. 2003, *available at* http://www.businessweek.com/magazine/content/03_40/b3852001_mz001.htm.
[19] *Id.*
[20] Interview by Frontline with Gary Gereffi, Professor, Duke University (Sept. 9 2004), *available at* http://www.pbs.org/wgbh/pages/frontline/shows/walmart/interviews/gereffi.html .

from China.[21] Last year, Wal-Mart planned to purchase more than $2 billion in goods from India,[22] and to increase purchasing of Malaysian products by 20 percent.[23]

The adverse effect that Wal-Mart has had on local businesses, workers, and communities in the retail industry should not be permitted to repeat itself in the banking industry. An industrial bank charter would give Wal-Mart the opportunity to destroy local banks much as it has destroyed other local businesses such as grocers, pharmacists, and florists. If competitor banks are destroyed, surviving local businesses would be forced to go to their biggest competitor for deposits and loans, providing Wal-Mart with an even greater competitive advantage and creating a nightmare scenario which is a key reason for the longstanding U.S. policy prohibiting the mixture of banking and commerce.

A Wal-Mart bank also will not help the local community in Salt Lake City. Wal-Mart has indicated in its application that it will outsource many of the bank's functions (although it has failed to reveal where or to whom). Wal-Mart's application states that it will outsource its general ledger and accounting system and implies that it will outsource its information systems. Not only will this deprive the local community of jobs, the lack of information about how and where this outsourcing will occur raises troubling questions about the bank's operations and oversight. The application also pointedly says only that Wal-Mart "does not have any plans to relocate the main office within the first three years of its operations."

For these reasons, a Wal-Mart bank would have an adverse impact on local communities – including banks, other local businesses, their workers, and their customers. This appears likely to be true in Salt Lake City and Utah as well as the rest of the country. Therefore, if the convenience and needs of the community are to be considered, the Wal-Mart application must be denied.

---

[21] The Economist, *Wal-Mart: How Big Can it Grow?,* April 15, 2004, *available at* http://www.economist.com/business/displayStory.cfm?story_id=2593089.
[22] India Business Insight, *Government to Set Up Panel to Help Wal-Mart Source Goods,* June 3, 2004.
[23] Namnews, *Malaysia: Wal-Mart To Increase Malaysia Sourcing By 20%,* Aug. 5, 2005, *at* http://www.kamcity.com/namnews/asp/newsarticle.asp?newsid=23489.

3. Wal-Mart's Legal and Ethical Problems Present Serious Risks to its Financial Condition and Future Earning Potential

One of the factors the FDIC is required to consider in determining whether or not to grant federal deposit insurance is "the adequacy of the depository institution's capital structure." Unfortunately, we are unable to comment on the company's current capital structure due to the inadequacy of the public information available in connection with Wal-Mart's application. We urge the FDIC to be more forthcoming with such information in light of the significant policy questions raised by Wal-Mart's application and its market dominance.

Although we are unable to comment on specific financials, we are aware of worrisome trends that could affect the company's financial condition, as well as that of a Wal-Mart bank. Wal-Mart is one of the most often-sued companies in history. Wal-Mart was reportedly sued 4,851 times in 2000 — or nearly once every two hours, every day of the year[24] - and continues to be besieged by litigation. These lawsuits create enormous potential liabilities that could eventually lead the company, and, if it acquires one, its bank to fail. For example, an employment discrimination class action is currently pending in which the plaintiffs, over 1.5 million current and former female employees, could be entitled to as much as $10 billion in back pay, punitive damages, and raises. The case may lead to a very expensive judgment or settlement. In addition, Wal-Mart recently has entered into a $11 million settlement agreement over a federal investigation of its labor practices and been fined $3.1 million for violations of the Clean Water Act. These troubles could also scare away investors, require expensive fixes, and lead to a decrease in profits and stock prices.

The cases cited above are just a small, recent sampling of the lawsuits that have been brought against Wal-Mart. The potential liabilities stemming from present and future lawsuits

[24] Richard Willing, *Lawsuits a Volume Business at Wal-Mart*, USA Today, Aug. 13, 2001, *available at* http://www.nfsi.org/walmart/Lawsuits%20a%20volume%20business%20at%20Wal-Mart.htm (last visited Aug. 2, 2005).

create huge financial risks for the company. In May of 2005, a group of institutional investors holding more than $545 million worth of Wal-Mart stock voiced concern about an apparent breakdown in the company's legal and regulatory controls. The group, which included William C. Thompson Jr., the comptroller of New York City, stated that they were "deeply concerned about contingent liabilities and negative effects on the company's stock price and reputation," and urged the company to establish a special committee of independent directors to review and report on the company's legal and regulatory controls. [25]

The shareholders warned the company that "recent reports of legal and regulatory non-compliance raise serious concerns about the adequacy of the company's controls," and that "the frequency of the reports suggests that non-compliance with internal standards, as well as with laws and regulation, may be far too commonplace at Wal-Mart."[26] The letter cited raids of 60 Wal-Mart stores in 21 states by U.S. federal agents that resulted in the arrest of 250 illegal immigrant workers and the $11 million settlement mentioned above, and a 2005 settlement with the U.S. Department of Labor involving more than 24 violations of child labor laws in three states.

The shareholders also voiced concern about a recent corporate scandal. Former Wal-Mart Vice Chairman Thomas Coughlin reportedly was forced to resign from Wal-Mart's board after an internal investigation alleged that he abused his expense account and used fraudulent invoices to obtain reimbursements. Coughlin allegedly informed co-workers that the funds were actually a "round-about way" of compensating him for out-of-pocket expenses he made to wage an anti-union campaign involving bribes.[27] The shareholder letter also noted that the employee who reported Coughlin's suspect transactions was subsequently fired. If it is discovered that Wal-Mart executives have been misusing company funds to finance illegal anti-union activities,

---

[25] Letter from William C. Thompson, Jr., Comptroller, The City of New York, *et. al.*, to Roland A. Hernandez, Chair, Audit Committee of the Board of Directors, Wal-Mart Stores, Inc. 1 (May 25, 2005) *available at* http://www.comptroller.nyc.gov/press/2005_releases/PR05-06-067.shtm.
[26] *Id.*
[27] James Bandler & Ann Zimmerman, *Petty Cash: A Wal-Mart Legend's Trail of Deceit,* Wall Street Journal, Apr. 8, 2005, *available at* http://mindfully.org/Industry/2005 /Wal-Mart-Coughlin8apr05.htm.

this could lead to further litigation, reduce investor confidence in the company, and have serious financial consequences.

Wal-Mart's increasingly negative public image has led to countless organized challenges from citizens and local governments seeking to keep Wal-Mart out of their communities.[28] These efforts could pose a threat to Wal-Mart's future growth and overall financial health. The company's pattern of legal and regulatory non-compliance is particularly concerning because, as an industrial bank, it would not be regulated by the Federal Reserve as are other bank holding companies. Therefore, the potential financial impact of Wal-Mart's frequent legal and regulatory violations and resulting liabilities may not be detected in time to prevent financial problems before they endanger the bank and FDIC insurance. As Wal-Mart shareholders have themselves cautioned, "the risks associated with a compliance breakdown are especially onerous for Wal-Mart and its shareholders in light of the company's large size and market capitalization."[29]

4. Concerns about Wal-Mart Meeting FDIC Standards for Management Character and Fitness

One of the criteria by which the FDIC must evaluate this application is the general character and fitness of management. We sincerely hope that any unproven claims against Wal-Mart are false, and that past violations will not be repeated, but Wal-Mart's existing track record of legal and ethical violations is too much to ignore. Under these circumstances, we do not believe that Wal-Mart's management should be extended the authority and responsibility that comes with an industrial bank charter and FDIC insurance, particularly in light of the fact that Wal-Mart will not be subject to consolidated supervision by the Federal Reserve.

---

[28] *See, e.g.,* Julie Edgar, *Township May Shut Door on Wal-Mart,* Detroit Free Press, July 27, 2005; Laura Counts, *'Super' Grocery Outlets Banned in Oakland; Lawmakers Vote to Turn Away Wal-Mart and Target,* Alameda Times-Star, Oct. 23, 2003; *Wal-Mart Hits Big Apple Pothole,* CNNMoney.com, Feb. 24, 2005; Russell Max Simon, *Wal-Mart Battle Comes to Santa Fe,* Albuquerque Journal, April 24, 2004, at Journal North Pg. 1; Donal O'Connor, *City Urged to Say No to Wal-Mart; Crowd Cheers as Speakers Blast U.S. Retail Giant,* Stratford Beacon Herald, June 21, 2005, at News Pg. 1.

[29] Letter from William C. Thompson, Jr. at 2.

The reports of violations of labor and environmental laws, alleged discrimination in employment and sales practices, and negative impacts on communities raise questions about the character of Wal-Mart's management. The picture these allegations paint is just what Wal-Mart's shareholders found – that breaking laws and regulations is "far too commonplace" at Wal-Mart.

Many of Wal-Mart's shareholders have expressed concern regarding the ethical lapses of the company's management. With respect to the scandal over Coughlin's alleged misuse of company funds, a shareholder group stated that the incident merely "bolstered the public perception of a culture of non-compliance and disregard for ethical standards within the ranks of Wal-Mart management."[30] In light of Wal-Mart's practices and legal problems, the FDIC cannot assure itself that Wal-Mart's management will instill a culture of compliance and ethical practices at its bank that will protect its customers and the public.

* * *

Some may argue that Wal-Mart should be granted an ILC charter and federal deposit insurance out of fairness because one of its competitors, Target, has an ILC. The Target situation, however, was very different and it should not impact the FDIC's decision here in any way. Wal-Mart's application is different from Target's in three principal ways:

- History: As I said earlier, Wal-Mart has tried three times to secure an ILC charter, each time making clear the company's intention to branch. After being rebuffed all three times, in this, their fourth attempt, the company claims no intention to enter retail banking or branch. The drastic change in business plan leads us to question the company's long-term intentions.
- Size: Wal-Mart is seven times the size of Target. Thus, there really is no comparison in terms of its ability to take advantage of the ILC loophole as opposed to Target's. Once the largest company in the country is allowed into banking under an "exception," that exception will have swallowed the rule.

---

[30] *Id.*

- Infrastructure: Wal-Mart currently has banks in 1000 of its stores in the United States. It would be relatively easy for a Wal-Mart store to switch from a tenant bank to Wal-Mart Bank. These stores are "bank ready" – they have bank infrastructure in place and their customers already do their banking at Wal-Mart. The company argues that they have leases with their bank tenants that would prevent this, but the leases have been written so that Wal-Mart can get out of them at a minimal price.

In sum, Wal-Mart's application for an industrial bank is troubling on many fronts. The company's application does not meet the basic legal requirements upon which the FDIC judges such applications and it would expand the ILC loophole in the BHCA so dramatically that the separation of banking and commerce would no longer be a recognizable principle. This, in turn, would weaken the entire banking system and put FDIC insurance at risk.

We urge you to reject Wal-Mart's application.

Thomas J. Bliley
Collier Shannon Scott, PLLC
3050 K Street, NW Suite 400
Washington, DC 20007
202-342-8429
tbliley@colliershannon.com